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September 8, 1997

BY OVERNIGHT MAIL

Mr. William F. Caton
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Federal Communications Commission
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Re: CC Docket No. 96-128

Dear Mr. Caton:

Enclosed for filing please find an original plus eleven (11) copies of the Reply Comments of Frontier Corporation in the above-docketed proceeding.

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Michael J. Shortley, III

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Before the
FEDERAL COMMUNICATIONS COMMISSION
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SEP - 9 1997

In the Matter of

Implementation of the Pay
Telephone Reclassification
and Compensation Provisions
of the Telecommunications
Act of 1996

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CC Docket No. 96-128

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REPLY COMMENTS OF
FRONTIER CORPORATION

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September 8, 1997

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Section 276 requires that payphone owners receive “fair compensation” for the costs that they incur in handling calls. Contrary to the clear purposes of section 276, the payphone industry, predictably, has treated section 276 as a brand-new, government-sanctioned handout by which they should receive unconscionable amounts that could exceed \$2 billion per year. Apparently, payers -- principally, interexchange carriers and consumers that will ultimately foot the bill for this largesse -- simply do not matter.

In this remand proceeding, the Commission should ignore these pleas and follow the dictates of section 276 and the D.C. Circuit’s remand of its previous order. In particular, the Commission should set the per-call payphone compensation rate based upon the costs of completing subscriber 800 and access code calls. The comments conclusively demonstrate that these costs fall within the range of 5.7 to 11 cents per call. Awarding “compensation” at any higher rate would be inconsistent with the statute and result in massive consumer harm. The Commission should also abandon any effort to resurrect an interim compensation plan.

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FEDERAL COMMUNICATIONS COMMISSION
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**REPLY COMMENTS OF
FRONTIER CORPORATION**

Introduction

Section 276 requires that payphone owners receive "fair compensation" for the costs that they incur in handling calls. Contrary to the clear purposes of section 276, the payphone industry, predictably, has treated section 276 as a brand-new, government-sanctioned handout by which they should receive unconscionable amounts that could exceed \$2 billion per year. Apparently, payers – principally, interexchange carriers¹ and consumers that will ultimately foot the bill for this largesse – simply do not matter.

In this remand proceeding, the Commission should ignore these pleas and follow the dictates of section 276 and the D.C. Circuit's remand of its

¹ The Payphone Coalition (the RBOCs, GTE and SNET) reluctantly concedes (Payphone Coalition Comments at 34-35) that its members should pay compensation. However, the payphone compensation that they would receive under the scheme that they propose would undoubtedly far outweigh the compensation that they owe.

previous order.² In particular, the Commission should set the per-call payphone compensation rate based upon the costs of completing subscriber 800 and access code calls. The comments conclusively demonstrate that these costs fall within the range of 5.7 to 11 cents per call.³ Awarding "compensation" at any higher rate would be inconsistent with the statute and result in massive consumer harm. The Commission should also abandon any effort to resurrect an interim compensation plan.

Argument

I. THE COMMISSION SHOULD ESTABLISH A REASONABLE AND DEFENSIBLE PER-CALL COMPENSATION RATE.

The payphone providers' arguments to the contrary, the Commission may not rely upon so-called "market-based" surrogates to establish a per-call compensation rate. Even Peoples Telephone -- the nation's largest independent payphone provider -- agrees that a cost-based methodology is the appropriate approach for setting payphone compensation.⁴ The evidence to date demonstrates that the payphone providers' compensation demands are grossly excessive. If the Commission, nonetheless, accedes to these short-sighted demands, consumers and, ultimately, payphone providers will suffer.

² *Illinois Public Telecommunications Ass'n. v. FCC*, No. 96-1394, slip. op. (D.C. Cir. July 1, 1997) ("IPTA").

³ See AT&T Comments at 6-13; Sprint Comments at 8-11.

Frontier suggested a rate of 10 cents per call based upon the evidence that had been compiled to date. Frontier Comments at 6-9. That rate falls at the high end of the range of reasonableness.

⁴ Peoples Comments at 8.

A. Section 276 of the Act and Prior Commission Precedent Require that Compensation Be Set at Cost-Based Rates.

Section 276 of the Act requires “fair[] compensat[ion] *for*” each and every completed call.⁵ As Sprint cogently demonstrates,⁶ the statute does not require that compensation be paid *from* each such call. The evidence also suggests that payphone providers already receive, in the aggregate, fair compensation for the calls that they handle.⁷

Despite Sprint’s analysis – which Frontier believes is absolutely correct – the Commission plainly will not set a per-call compensation rate for coinless calls equal to zero. Fair compensation, however, does not equate to the largesse that the payphone providers seek. As such, the RBOC coalition’s distortion of the record in this regard to increase their own windfall should be ignored by the Commission.

Contrary to the contention in some comments that the Court endorsed the Commission’s “market-based” approach,⁸ the Court did no such thing. It found the Commission’s syllogism: (a) the deregulated local coin rate best represents the *costs* of completing local coin calls; (b) the *costs* of sent-paid and coinless calls are similar; and (c) therefore, the deregulated local coin rate represents the best surrogate of the *costs* of completing local calls, was completely unjustified.⁹

⁵ 47 U.S.C. §276(b)(1)(A) (emphasis added).

⁶ Sprint Comments at 4.

⁷ *Id.*, quoting, “FCC Order Jump Starts Industry,” Phone+, December 1996 at 64-66.

⁸ Payphone Coalition Comments at 11-14; APCC Comments at 2-4.

⁹ IPTA at 22-27 (1997 U.S. App. LEXIS 16147).

The Court plainly tied its assessment of what constitutes reasonable compensation to the costs of completing coinless calls. The Court's analysis tracked the Commission's own orders and notices addressing this subject. Until now, the Commission has repeatedly stated that it should base compensation on the costs of completing coinless calls.¹⁰

Only in the Public Notice inviting comments on remand did the Commission even begin remotely to suggest that section 276 permitted it to set per-call compensation rates on "market-forces" divorced from costs and that it could decide which "market" forces should be taken into account.¹¹ This statement itself is a danger signal. It suggests that the Commission may have already made up its mind and is subject to yet another remand (and vacatur) should it continue on its current course.¹²

Fair compensation means what it means -- not rents that may be derived from locational monopolies -- but compensation to recover the minimum competitive costs of handling access code and subscriber 800 calls.¹³

¹⁰ See Sprint Comments at 1-3.

¹¹ *Pleading Cycle Established for Comment on Remand Issues in the Payphone Proceeding*, CC Dkt. 96-128, Public Notice at 2 (Aug. 5, 1997).

¹² See *Food Marketing Institute v. ICC*, 587 F.2d 1285, 1290 (D.C. Cir. 1978) ("... we must recognize the danger that an agency, having reached a particular result, may become so committed to that result as to resist engaging in any genuine reconsideration of the issues. ... *Post-hoc* rationalizations by the agency on remand are no more permissible than are such arguments when made by appellate counsel during judicial review.")

¹³ See Frontier Comments at 5.

B. The "Compensation" Demanded by the Payphone Providers Is Grossly Excessive by Any Reasonable Standard.

Under any approach suggested by the payphone providers, the compensation that they demand is grossly excessive. The self-styled "market-based" approaches -- which the Payphone Coalition claims results in a compensation rate *above* the local coin rate for coinless calls -- lack merit. In addition, the payphone providers' net avoided cost methodology amounts to blue smoke and mirrors. The claim that the Commission must engage in repeated cost-of-service proceedings to determine a per-call compensation rate is legally and factually insupportable.

1. The "Market-Based" Approach to Setting Compensation Rates Is Irrational.

The Payphone Coalition starts -- for any of its alternative theories -- with the deregulated local coin rate.¹⁴ This itself is not permissible as the deregulated local coin *rate* bears little relationship to the *costs* of completing *coin*, much less, coinless calls.¹⁵ Peoples Telephone acknowledges the inappropriateness of the Payphone Coalition's premise:

This general framework, however, is flawed and should not be the starting point of the Commission's further formulation of the default rate for dial around compensation. Such an analysis compares apples with oranges, (*i.e.*, values with costs), whereas the appropriate comparison would be one that examines the differences in costs between local coin calls and

¹⁴ Payphone Coalition Comments at 19, 20, 24.

¹⁵ See AT&T Comments at 4-5.

dial around calls, without comparing those cost differences to values.¹⁶

Nonetheless, starting with this premise, the Payphone Coalition suggests that, because *demand* for coinless calls is less elastic than the demand for coin calls, it necessarily follows that the compensation rate for coinless calls should be higher than that from coin calls.¹⁷ This is incorrect for three reasons.

First, it ignores that the majority of compensible calls made from payphones are subscriber 800 -- *not* access code -- calls, as the payphone providers concede.¹⁸ If the compensation rate is set too high, interexchange carriers will block these calls from payphones, or will surcharge payphone users.¹⁹ Since this choice is up to the affected carrier in the first instance, the relative demand elasticities of the sent-paid versus coinless calls from the perspective of the end-user is essentially irrelevant.²⁰

¹⁶ Peoples Comments at 8.

¹⁷ Payphone Coalition Comments at 20-24.

¹⁸ Peoples Comments at 6, Table 1.

¹⁹ The fact that a vast majority of subscriber 800 calls are not made from payphones is utterly irrelevant. These calls are currently profitable, regardless of the type of line from which the calls originate. The per-call surcharge will make subscriber 800 calls from payphones unprofitable. Because there would be no economic reason to raise rates for 800 services generally, carriers will need to recover these costs from the cost-causers -- *i.e.*, payphone users -- or avoid the costs altogether, by blocking such calls. Of course, if carriers block such calls, the compensation actually received by payphone owners will decrease. In effect, the exorbitant compensation being demanded by payphone owners creates a negative-sum game, one in which carriers, payphone providers and consumers alike all lose.

²⁰ Moreover, even if carriers choose to surcharge rather than block coinless calls, consumers will make less use of payphones.

Second, the market-based approach is fallacious in a more fundamental sense. It starts from the premise that the deregulated local *coin rate* is the appropriate measure of compensation for the costs incurred in completing coinless calls. That premise is false as the Court of Appeals concluded:

The problem with the FCC's decision is that the record in this case is replete with evidence that the costs of local coin calls versus 800 and access code calls are *not* similar. Numerous IXC's pointed out that the costs of coin calls are higher than those for coinless calls because of costs typically associated with use of coin equipment (e.g., the costs of purchasing the equipment and coin collection).... In addition, IXC's showed that the costs of local coin calls are higher because the PSP bears the costs of originating *and* completing local calls (i.e., the "end-to-end" costs); by contrast, for coinless calls, the PSP only bears the costs of *originating* the calls. Even the APCC, a trade group for independent PSPs, acknowledged that the costs of coin calls are higher than those of coinless calls.... AT&T estimated that the costs of local coin calls are three times higher than those for coinless calls....²¹

In short, there is no basis for beginning any analysis of the appropriate compensation rate with the deregulated local coin rate.

Third, the Payphone Coalition's elasticity analysis could be viewed as a statement that because coinless callers have less willingness or ability to utilize alternative calling options, more money may be expected from them. Of course, this attitude is consistent with the tawdry history of payphone pricing, hardly consumer-friendly.

²¹ IPTA at 23-24 (1997 U.S. App. LEXIS 16147) (citations omitted; emphasis in original).

2. Commissions Paid on 0+ Calls Are Not a Proper Basis for Establishing a Per-Call Compensation Rate.

The payphone providers alternatively suggest that commissions paid on 0+ calls (or other similar surrogates) provide a basis for establishing a per-call compensation rate.²² As Frontier explained in its comments,²³ this is simply incorrect. Moreover, it points up another fundamental fallacy in the demands of the payphone owners. Excessive payphone compensation will likely be used to compete up commissions paid to premises owners, as the payphone providers would now have an extra source of income -- unrelated to the costs of handling coinless calls -- to pay premises owners for the privilege of securing locations for their equipment. Excessive compensation will result in a transfer of wealth from carriers (and their customers) to premises owners.²⁴ There is no hint in section 276 or its legislative history that Congress sought to enrich premises owners -- much less payphone providers -- at the expense of the public.

3. The Payphone Providers "Cost-Based" Methodology Is Fallacious.

The payphone providers finally suggest that, if the Commission adopts a cost-based approach, it should still establish a per-call compensation rate above that of the local coin rate.²⁵ The Commission should do no such thing.

²² Payphone Coalition Comments at 24-26; APCC Comments at 7-10.

²³ Frontier Comments at 5.

²⁴ See Sprint Comments at 9-10.

²⁵ Payphone Coalition Comments at 19-20; APCC Comments at 11-17; Peoples Comments at 8-15.

First, and yet again, the payphone providers start from the premise that the deregulated local coin rate is the correct starting point for determining the appropriate per-call compensation amount for coinless calls.²⁶ Completely missing from the analysis or data submitted by the Payphone Coalition is any discussion of the actual costs that they incur in handling coinless calls. This is not surprising because the only evidence from the payphone providers that relate to the costs of handling coin -- much less coinless -- calls by an arguably efficient payphone provider is that submitted by NYNEX (now Bell Atlantic) in Massachusetts.²⁷ That data -- which the interexchange carriers had to submit, because the Payphone Coalition chose not to -- shows that the costs of handling coin calls equates to 16.7 cents per call.²⁸ That figure -- not 35 cents or even 25 cents per call -- should form the starting point for the cost-based analysis that the Commission is obliged to undertake.²⁹

Only Peoples Telephone submitted cost data, purportedly showing that its average cost per call is 42 cents.³⁰ Even if this is true, it merely shows that -- compared to NYNEX/Bell Atlantic -- Peoples is an extremely inefficient payphone service provider. The Commission need not compensate a payphone provider

²⁶ Payphone Coalition Comments at 15.

²⁷ See Sprint Comments at 8-9.

²⁸ *Id.*

²⁹ That the Payphone Coalition consciously refused to supply cost data should be taken as conclusive evidence *against* them that their costs of handling coinless calls are orders of magnitude less than the exorbitant compensation that they demand.

³⁰ Peoples Comments at 10, Table 2.

for costs that are two and one-half times higher than those of an efficient provider. Moreover, Peoples' data is merely an update of the study it previously submitted,³¹ which the Court of Appeals plainly did not credit. Finally, when costs that are not appropriately assigned to subscriber 800 and access code calls -- line charges (\$0.08), commissions (\$0.09), field services (\$0.06), overhead (\$0.04) and equipment costs (\$0.09) -- are removed,³² Peoples' own data shows that its costs of handling coinless calls amounts to 6 cents per call.

Second, the payphone providers' analysis of cost offsets³³ is flawed. Claiming that coin-handling and related costs are joint and common, they attribute a disproportionately small share of such costs to *coin* calls.³⁴ On its face this logic is questionable. It is also irrelevant. That a coin telephone is capable of handling both coin and coinless calls does not mean that any coin-related costs may properly be attributable to coinless calls. As described above,³⁵ the economic decision to place a payphone is based on coin revenue. Accordingly, all of the costs attributable to coin-related functions should be allocated to coin -- not coinless -- calls.

³¹ *Id.* at 9 n.12.

³² *See infra* at 10-11.

³³ *See* Payphone Coalition Comments at 15-17.

³⁴ *Id.* at 16-17.

³⁵ *See supra* at 3 n.7 ("I've always maintained one thing," says Jerry Burger, chief executive officer of Americall. "I did not accept a location if I could not amortize 100% of my principal and interest payments and all of my salaries, general and administrative expenses strictly out of coin. If I had to depend on the revenue from operator services, let alone surcharges, I didn't want the phone. To me, operator services and any type of surcharges revenue is strictly gravy.").

The payphone providers also suggest that -- because there are no explicit, usage-based charges for terminating local coin calls in many jurisdictions -- the local termination charge in such jurisdictions is effectively zero.³⁶ However, even if the local line rate is flat-rated, usage-based costs are bundled into that rate and, therefore, must be taken into account.³⁷

The concept that payers should contribute to commission costs misses the mark. As described above,³⁸ commissions are transfers to premises owners and section 276 of the Act simply does not contemplate a transfer of wealth from consumers to premises owners.

Third, the Payphone Coalition's cost onset discussion³⁹ is equally spurious. It amounts to the proposition that payphone providers should *also* be compensated for costs that *others* will incur in order to *pay* compensation. This crosses the line into the absurd.

Logically, payphone providers should only receive compensation *net* of, *not in addition to*, these costs. Both interexchange and exchange carriers will spend (or have already spent) hundreds of millions, if not billions, of dollars to be

³⁶ Payphone Coalition Comments at 15-16.

³⁷ Although Frontier would go as far as AT&T and require that such charges be explicitly unbundled (AT&T Comments at 10 n.13), AT&T's point -- that the Commission must account for such costs that are not incurred in handling coinless calls -- is well taken.

Moreover, there is no reason to include line costs in the formula for determining the appropriate level of compensation. Interexchange carriers already contribute to line costs through the payment of access charges.

³⁸ See *supra* at 8.

³⁹ Payphone Coalition Comments at 17-19.

able to pay payphone compensation. Yet, the payphone providers are the *sole* economic beneficiaries of payphone compensation. It would, therefore, be not only fair, but also economically rational, that payphone providers be responsible for these costs. Thus, these costs are not *onsets*, but *offsets*, for which the payphone providers should be responsible before they receive any compensation whatever.

C. The Commission Should Ignore the Scare Tactics of the Payphone Providers.

The Payphone Coalition wants to scare the Commission into awarding excessive payphone compensation by claiming that twenty percent of the nation's payphones are at risk if the Commission fails to accede to their demands.⁴⁰ There are three answers to this claim: (a) it is incorrect; (b) it is irrelevant; and (c) it ignores the consumer losses that excessive payphone would entail.

First, the payphone industry itself claims that payphones are placed where they will generate a sufficient return on coin traffic alone.⁴¹ Because this appears to be the economically rational basis for placing payphones -- as *recognized by those in the industry* -- there is no basis for the Commission to place any credence in this scare tactic. Exorbitant compensation is not necessary to insure that there are a sufficient number of payphones deployed to

⁴⁰ *Id.* at 24.

⁴¹ See Sprint Comments at 4.

serve the public.⁴² Presumably, if payphone owners received *no* additional compensation whatsoever, they would have made the same economic decision to place and keep their payphones in place.

Second, the Commission has never been under -- and section 276 does not impose -- an obligation to ensure the financial viability of any companies under its jurisdiction. As Sprint cogently demonstrates,⁴³ for decades, the Commission has recognized that it need only offer the opportunity for efficient providers to earn a fair return.⁴⁴

Third, the Payphone Coalition's scare tactics ignore the interests of carriers and consumers. Were the Commission unthinkingly to mandate per-call compensation rates far in excess of costs, all industry participants would lose. Consumers will lose as payers pass the costs of payphone compensation onto

⁴² Section 276 of the Act never contemplated that deployment of payphones, whether economically justified or not -- was a *sine qua non* of the Act. Section 276 encourages the deployment of payphones where such deployment will inure to the benefit of the general public. 47 U.S.C. § 276(b)(1). Encouraging the deployment of payphones that would be uneconomic absent receipt of payphone compensation would not benefit the public, particularly in comparison to the costs that the public will ultimately be required to absorb.

⁴³ Sprint Comments at 6-8.

⁴⁴ As Frontier demonstrated in its comments, this approach is entirely consistent with the Courts' acceptance of industry-wide rate prescriptions. Frontier Comments at 4 n.11.

This disposes of the Payphone Coalition's concern (Payphone Coalition Comments at 27-30) that a cost-based standard would require the Commission to conduct extensive and repetitive cost or rate proceedings. If anything, the Commission should subject the initial per-call compensation amount to some form of price cap so that payphone providers are encouraged to maximize efficiency.

Finally, the Commission should affirmatively reject APCC's contention (APCC Comments at 4-5 n.2) that payphone providers are not subject to a "just and reasonable" standard. While this may be true in general (despite the numerous complaints that the payphone industry has generated), it is plainly incorrect when it comes to the level of compensation. See Frontier Comments at 3-4.

users⁴⁵ or will block calls -- particularly subscriber 800 calls -- that would result in a compensation obligation.⁴⁶

Carriers and consumers are the obvious losers as they are forced to squander resources to implement payphone compensation. The greater the level of compensation ordered by the Commission, the greater the harm to carriers and consumers alike.

Payphone providers themselves will fare worse under the very scheme that they propose. If carriers choose to block calls, payphone providers will receive none or little of the compensation that they apparently anticipate.

II. THE COMMISSION SHOULD DECLINE TO RESURRECT ITS INTERIM COMPENSATION PLAN.

Based upon the D.C. Circuit's remand (and vacatur) of the Commission's first attempt to establish an interim compensation plan, the Commission cannot recreate a plan substantively comparable to the one rejected by the Court that could survive further judicial scrutiny. Although others have suggested means to

⁴⁵ The Commission has gone to lengths to avoid a "caller-pays" system of compensation (*see* IPTA at 33-37 (1997 U.S. App. LEXIS 16147)) although such a system would be the most economically efficient. What the Commission ignores is that, in the end, payphone users *will* pay. Carriers will not be able simply to absorb this cost -- which, in the case of Frontier, will amount to millions of dollars *per month*. Nor is there any reason for carriers to raise rates generally. To the extent that these costs are passed on, they will be passed on directly to payphone users.

⁴⁶ As Frontier observed in its comments (Frontier Comments at 5), the second largest source of consumer complaints that the Commission receives today relates to excessive rates for calls made from payphones. If the Commission decrees excessive compensation, it may confidently expect the number of such complaints to exceed even the number of slamming complaints, as consumers object either to payphone surcharges, excessive payphone rates as such, or blocked calls.

do so, none meets the terms of the remand. Sprint's suggestion⁴⁷ -- that the Commission base an interim plan on per-call data from November 1997 -- does not work because it does not relate to payphone-originated coinless calls made during the interim period. Similarly, AT&T's approach⁴⁸ -- which relies on total toll revenue as shown on the universal service worksheets -- fails to address the defect found by the Court that total toll revenues bear no relationship to payphone-originated revenues.⁴⁹ While Frontier is sympathetic with the intent of parties that suggested means of correcting the Commission's mistakes in this regard, it does not believe that there is a way to do so consistent with the D.C. Circuit's decision.

Finally, it is important to note that section 276 of the Act did not require that compensation begin at any particular point in time.⁵⁰ At this point, it is more important that the Commission set the per-call compensation amount correctly. Wasting even more time trying to resurrect an interim compensation plan would amount to no more than a waste of the Commission's time and resources.

⁴⁷ Sprint Comments at 13.

⁴⁸ AT&T Comments at 20.

⁴⁹ IPTA at 28-29 (1997 U.S. App. LEXIS 16147).

⁵⁰ Section 276 only required the Commission "to prescribe regulations" implementing its substantive provisions within nine months of enactment. 47 U.S.C. § 276(b)(1).

Conclusion

For the foregoing reasons, the Commission should act on remand in the manner suggested herein.

Respectfully submitted,



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September 8, 1997

Certificate of Service

I hereby certify that, on this 8th day of September, 1997, copies of the foregoing Reply Comments of Frontier Corporation were served by first-class mail, postage prepaid, upon the parties on the attached service list.



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